

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2004-537

November 8, 2004

NORTHERN UTILITIES, INC.
Request for Approval of Affiliated Interest
Transaction with NiSource Corporate
Services, Inc.

ORDER

Welch, Chairman; Diamond and Reishus, Commissioners

I. SUMMARY

We approve the Stipulation and Settlement executed by Northern Utilities, Inc. (NU, Northern or the Company) and the Office of the Public Advocate (OPA), and the proposed Service Agreement with NiSource Corporate Services Company (NCSC), subject to the conditions outlined below. Our approval of the contract does not constitute a determination of the reasonableness of any costs that may be charged to NU under this contract for inclusion in future rates.

II. OVERVIEW

A. Procedural History

On August 6, 2004, NU filed a petition requesting approval of a Management Service Agreement (MSA) with its affiliate NiSource Corporate Services Company (NCSC), pursuant to 35-A M.R.S.A. § 707.

The OPA's petition to intervene was granted at the initial case and technical conference on September 29, 2004. The Commission's Advisory Staff (Staff) issued a written data request and Staff and the OPA conducted additional discovery during the September 29 conference. At this conference, the Hearing Examiner also orally approved Northern's request for protective treatment of information related to the SEC's audit of NCSC, pending receipt of additional information from Northern regarding the protected status of this information afforded by the SEC. A written protective order was issued on November 4, 2004.

On October 29, 2004, Northern filed a Settlement and Stipulation executed by it and OPA, recommending approval of the proposed revised affiliate management services agreement.

B. Background

Following the merger of NiSource, Inc. and the Columbia Energy Services, approved in *Request for Approval of Reorganization – (NiSource – Columbia Merger*

and Related Transactions), Docket No. 2000-322, NiSource formed a corporate services group, NCSC, to consolidate the service needs of its affiliates. NCSC provides the majority of management services to the NiSource affiliates and, as a result, has an agreement with each of the affiliates to provide such services. The agreement also spells out how NCSC will allocate costs to affiliates. The Commission approved a predecessor to this agreement in Docket No. 2002-21 by Order dated July 2, 2002. According to NU, the Service Agreement in the current docket is a refinement of the 2002 Agreement to make its terms consistent among the affiliates in the NiSource family, taking into account state differences, as well as to limit the inclusion of allocation methodologies to those that are actually used and reflected in the Agreement.

C. Legal Authority

Title 35-A § 707(3) prohibits utilities from transacting for services with affiliates unless we have found that the arrangement is not adverse to the public interest and have given it written approval. Subsection 707(3)(B) authorizes the Commission to grant approval subject to such terms and conditions as it determines necessary to safeguard the public interest. Subsection 707(3)(D) states that approval of an arrangement under this section does not limit or restrict the Commission's authority under Title 35-A in determining any rate, charge, or schedule.

Chapter 820 of the Commission's Rules governs the record keeping, accounting, and structural requirements for non-core utility activities and transactions between affiliates. Subsection (4)(E) of the rule specifies that equipment, facilities, services or personnel of an affiliate used by a utility shall be priced at the same price charged non-affiliates, or, if no such price is available, at market price. In the absence of a tariffed rate or market price, Chapter 820(4)(A) requires that utility services provided to affiliates be priced using a fully distributed cost (FDC) methodology as a proxy for market value. Subsection 9 of the rule allows us to waive the requirements of Chapter 820 if good cause is shown and that the waiver would not be inconsistent with the requirements of sections 707, 708, 713, 714 and 715 of Title 35-A.

III. **PROPOSED MANAGEMENT AGREEMENT**

In its application, Northern requests approval of its revised Service Agreement with NCSC. This agreement outlines both the types of services to be provided and the methodology by which the costs of providing those services will be charged. According to NCSC representatives, the proposed Service Agreement is identical for all the companies, both regulated and non-regulated, in the NiSource corporate family. Appendix, Article 2, Description of Services, outlines the services NCSC may provide to its affiliates, including:

- Accounting and Statistical Services
- Auditing Services
- Budget Services
- Business Promotion Services

- Corporate Services (includes dealings with regulatory bodies)
- Data Processing, Tabulating and Calculating Services
- Depreciation Services
- Economic Services
- Electronic Communication Services
- Employee Services
- Engineering and Research Services
- Gas Dispatching Services
- Geology and Production Services
- Information Technology Services (new in revised agreement)
- Information Services
- Insurance Services
- Legal Services (new in revised agreement)
- Office Space
- Officers
- Operational and Planning Services
- Purchasing and Storage Services
- Rate Services
- Tax Services
- Transportation Services
- Treasury Services (new in revised agreement)
- Land/Surveying Services (new in revised agreement)
- Miscellaneous Services

The Service Agreement states that NCSC will furnish such services to Northern "as the Client may from time to time request." In most instances, the service description states that NCSC will "advise and assist" the affiliate in the matters at issue and will perform certain services at the affiliates' request.

Article 3 of Appendix A of the Management Service Agreement discusses allocation methods used to bill for services rendered. All costs incurred on behalf of affiliated companies will be charged utilizing direct billing whenever possible. When direct billing is not possible, NCSC will allocate costs utilizing an approved SEC allocation bases.

The administrative and/or indirect costs of NCSC will be accumulated and then charged as an overhead adder on all direct labor charges made to affiliated companies based upon each individual company's percentage of direct labor charges to the total NCSC direct labor charges.

IV. STIPULATION

The Stipulation and Settlement filed by Northern and the OPA recommends that the Commission find that the proposed affiliate agreement is not adverse to the public interest as required by 35-A M.R.S.A. § 707. The Stipulation also states that the parties

agree that Northern will fully comply with Chapter 820 of the Commission's Rules in its performance of the affiliate agreement and that no waivers are necessary or sought by Northern for its use of fully distributed cost in charges for services from NCSC to Northern. Finally, the Stipulation states that charges under the "Miscellaneous Services" provision of the affiliate agreement must be incurred only for services that could reasonably be considered appropriate for a natural gas LDC to be recoverable in rates from Maine customers. In addition, Northern shall bear the burden of demonstrating this at the time it seeks to recover such costs, if at all, in base rates.

The Stipulation contains procedural provisions in which the parties waive their rights to a written Examiner's Report and an opportunity to file exceptions thereto, and establishes the non-precedential effect of this Stipulation. The Stipulation also proposes that the record of this proceeding shall consist of transcripts and documents (including data requests and responses) filed with the Commission.

V. ANALYSIS & DECISION

A. Settlement

When considering stipulations we apply the following criteria:

- 1) whether the parties joining the stipulation represent a sufficiently broad spectrum of interests that the Commission can be sure that there is no appearance or reality of disenfranchisement;
- 2) whether the process that led to the stipulation was fair to all parties;
and
- 3) whether the stipulated result is reasonable and is not contrary to legislative mandate.

See *Central Maine Power Company, Proposed Increase in Rates*, Docket No. 92-345(II), Detailed Opinion and Subsidiary Findings (Me.P.U.C. Jan. 10, 1995), and *Maine Public Service Company, Proposed Increase in Rates (Rate Design)*, Docket No. 95-052, Order (Me.P.U.C. June 26, 1996). We are satisfied that the proposed Stipulation in this case meets these criteria.

We have also recognized that we have an obligation to ensure that the overall stipulated result is in the public interest. See *Northern Utilities, Inc., Proposed Environmental Response Cost Recovery*, Docket No. 96-678, Order Approving Stipulation (Me.P.U.C. April 28, 1997). Accordingly, we review the terms of the affiliate agreement below.

B. NCSC Contract

In determining whether this contract is not adverse to the public interest, we must focus on three aspects of it. First, how much control does Northern have in determining whether it obtains services from NCSC rather than another source? Second, will the costs be allocated fairly among the NiSource family so that Northern will not subsidize the operating costs of other affiliates? Lastly, do the contract and the cost allocations specified therein meet the requirements of Chapter 820? Our goal in this review is to ensure that affiliate services are provided by NCSC only when Northern determines it is necessary and are priced fairly, e.g. to avoid cross-subsidies or unfair competitive advantages in the market place.

1. Northern Elects Services

We believe that NU should be able to determine the services that it needs from NCSC by comparing their nature and cost to the services available to it from its own employees and other vendors. We would expect Northern to compare both price and quality of services in making its selections. Nothing leads us to believe that the amount of control that Northern has over the services obtained from NCSC under the revised agreement is less than under the original management service agreement approved in Docket No. 2002-21.

To provide greater assurance that best cost options are pursued, we condition approval of this contract on the requirement that Northern provide support for the selection of NCSC as a provider for any service when Northern intends to request recovery of the related costs in rates. This includes providing support for the decision not to compare the overall cost of services received from NCSC with other providers as well as documentation of any actual searches made. The Commission's approval of the original agreement contained this condition.

2. Miscellaneous Services

The Miscellaneous Services provision included under Appendix A, Article II, paragraph 25 appears to be extremely broad. The service descriptions defined in paragraphs 1 through 25 of Article II already encompass most services that would be necessary for a natural gas LDC. We noted this in our approval of the initial NCSC contract in Docket No. 2002-21. Our concern was that the inclusion of such a provision might have the effect of making *any cost* fair game for pass through in customer rates. As we did in Docket No. 2002-21, and as the parties to the Stipulation have agreed, we condition our approval of the agreement so that charges under Miscellaneous Services will only be recoverable in rates if the services provided could reasonably be considered as traditional for a natural gas LDC. While all costs charged to Northern under the Service Agreement will be subject to review in a rate case, we are putting the Company on notice that this category of management service charges, regardless of their level, will receive heightened scrutiny.

3. Cost Allocation

Next, we look to how the costs will be allocated among affiliates. The NCSC job order system is essentially a refinement of the system and allocation methods previously used by Columbia Corporate Services group. The job order system essentially is unchanged from what was used when we approved the previous contract. All costs charged through NCSC are first assigned to a job order. When the job order is set up, the NCSC controller determines how the cost will be charged. Specifically, NCSC looks to determine which affiliates benefit from the service and should therefore be charged. When possible, those job orders are directly assigned to the affiliate or affiliates benefiting from the service. We strongly believe that whenever possible all costs should be directly assigned.

For costs that cannot be directly assigned, NCSC will determine which SEC-approved basis should be used to allocate costs after aggregating those costs with similar cost characteristics. NCSC cannot create or change a basis without obtaining authorization from the SEC. If a major project was to be initiated for which none of the current bases was appropriate, NCSC would be required to file with the SEC even if the appropriate basis was just a variation of an existing one (i.e. three companies versus four being charged).

Exhibit A to Appendix A of the Service Contract lists the SEC approved Bases of Allocation. The SEC required NCSC to eliminate any bases of allocation that it was not currently using.¹ The allocators that are either used or available for use include:

- Gross Fixed Assets and Total Operating Expenses
- Gross Fixed Assets
- Gross Depreciable Property and Total Operating Expenses
- Gross Depreciable Property
- Automobile Units
- Number of Regular Employees
- Fixed Allocation Percentage
- Number of Transportation Customers
- Number of Commercial Customers
- Number of Residential Customers
- Number of Retail Customers
- Number of High Pressure Customers
- Direct Costs

¹ The SEC conducted an audit of NCSC between our approval of the original NCSC agreement and the filing of this agreement. The Staff reviewed the findings made by the SEC as well as the responses by NCSC.

We have reviewed the SEC allocation bases and find that they appear to be reasonable for use as allocators for NCSC's costs to affiliates. However, what is more important than the bases themselves is whether NCSC selects the most appropriate bases to assign costs among the affiliates. As this cannot be determined in advance of selection, we would caution Northern to take note of all bases used to ensure that they are appropriate. We will consider the validity of costs allocated to NU in determining what costs are recoverable in rates in any future rate case.

4. SEC Filings

As stated earlier, NCSC must file with the SEC any requests for new or changed allocation bases. Under SEC procedures, if no response is received in 60 days, the bases are considered approved for use. We, therefore, require NCSC to provide us with timely copies of any such requests made of the SEC that would affect Northern to allow us an opportunity to comment on those requests.

The SEC conducts periodic examinations of holding company service companies under the Public Service Company Holding Company Act. As we did in Docket No. 2002-21, we will condition our approval of this request on NCSC notifying us of any such audits to allow us the opportunity to participate to the degree we feel necessary, and providing us with copies of all preliminary and final reports, as well as of the NCSC's responses to those reports, when made.

5. Chapter 820

Chapter 820 of the Commission's rules establishes a preference for market pricing for service billings among members of an affiliated group. *Central Maine Power Company, MaineCom Services, Maine Natural Gas, LLC, Maine Electric Power Company, Chester SVC Partnership, Request for Approval of Affiliated Interest Transaction for Two Service Agreements with Energy East Management Corporation*, Docket No. 2001-178, Order Approving Stipulation (July 10, 2001) at 4, 6. If a tariffed rate or market price is not available, Chapter 820(4)(A) requires that utility services provided to affiliates be priced using a fully distributed cost (FDC) methodology as a proxy for market value. The requirements of Chapter 820 are designed to avoid cross-subsidies and to avoid creating an inter-affiliate competitive advantage.

In Docket No. 2001-178, we approved the provision of services by Energy East Management Corporation (EEMC) to its regulated utility affiliates priced using FDC methodology, and waived the market price requirement in Ch. 820(4)(E). We did so finding that Energy East's cost methodology would be subject to SEC scrutiny and would be done according to the SEC requirement that all costs be charged using a FDC mechanism. In *Bangor Hydro-Electric Company, Request for Approval of Reorganization and Affiliated Interest Transactions with Emera Energy Services, Inc.*, Docket No. 2001-841, (Jan. 8, 2002) Order at 14, we similarly noted

Because of the impracticality of determining the value of services when there is no active market in which those services are bought and sold, Chapter 820 allows the use of fully distributed cost methodology, "when the market value cannot be practically determined." The value determined in accordance with such methodology thus acts "as a proxy for the market value." Chapter 820 Order at 21. ... Thus, in adopting Chapter 820, we have already determined, in general, that the use of FDC methodology is an appropriate proxy for determining the market value of a service....

As in Docket No. 2001-178, we find good cause to waive the provisions of Chapter 820(4)(E) to allow NCSC to provide services to Northern at FDC using SEC methodologies, rather than market price, if market price cannot be practically determined. Moreover, we find that such a waiver is not inconsistent with the requirements of sections 707, 708, 713, 714 and 715 of Title 35-A. However, in any rate proceeding, we will require Northern to demonstrate the reasonableness of including in rates any affiliate cost that is not provided at market price. In a stipulation that was filed in Docket No. 2001-178, the parties agreed to the following:

For ratemaking purposes, each of the applicants will provide appropriate market information (which shall mean market rates for such services or, if the applicants conclude that no market rates are available, the explanation supporting the unavailability of market rates) to demonstrate that the costs billed under these agreements are just and reasonable. Such market information shall only be required if and to the extent that an applicant is seeking (or another party is requesting) a rate change (whether in a general rate proceeding, pursuant to a bottom-end earnings sharing mechanism, or as a result of a mandated cost) that includes costs billed under the agreements approved herein. In such a proceeding seeking a rate change, any other party is free to contest the reasonableness of the costs incurred under the agreements approved herein and the applicant seeking to include such costs in its rate change shall have the burden of proof as to the reasonableness of such costs.

We make this provision a condition of our approval, as we did when we approved the prior agreement in Docket No. 2002-21. In any instance where Northern proposes to include in rates a cost for affiliate services provided at other than market price, it must indicate why market rates were not used in accordance with Chapter 820.

VI. CONCLUSION

For the reasons described above, we find Northern's Service Agreement with NCSC not adverse to the public interest. The Settlement and Stipulation indicates that it is void if not accepted by the Commission according to its terms. It is unclear whether the Stipulation is now void due to the conditions we have placed on our approval of the Agreement. However, we assume that the parties will not object to these conditions because they are similar to provisions of Section III and are the same as we imposed on the prior agreement without objection or appeal. Accordingly, we also approve the Stipulation.

Accordingly, we

O R D E R

1. That the Stipulation and Settlement executed by Northern Utilities, Inc. and the Office of the Public Advocate is approved; and

2. That Northern Utilities, Inc.'s proposed Service Agreement with NiSource Corporate Services Company is approved subject to the conditions contained in this Order.

Dated at Augusta, Maine, this 8th day of November, 2004.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
 Diamond
 Reishus

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.
2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within **21 days** of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.
3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.